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**COMMISSION STAFF WORKING DOCUMENT**

**Analysis of the draft budgetary plans of Luxembourg**

*Accompanying the document*

**COMMISSION OPINION**

**on the draft budgetary plan of Luxembourg**

{C(2016) 8011 final}

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#### 1. INTRODUCTION

Luxembourg submitted its Draft Budgetary Plan (DBP) for 2017 on 14 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Luxembourg is currently subject to the preventive arm of the Pact and should preserve a sound fiscal position ensuring compliance with the medium-term objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission forecast. In addition, it includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis on the implementation by Luxembourg in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 12 July 2016, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

#### 2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

According to the macroeconomic scenario underpinning the DBP, economic prospects would remain favourable, with real GDP growth estimated to slow down to 3.1% in 2016 from 3.5% in 2015 and then to accelerate to 4.6% in 2017. Economic perspectives have been slightly revised upward compared to the 2016 Stability Programme, where GDP growth was projected at 2.9% and 4.5% for 2016 and 2017, respectively.

The macroeconomic scenario underlying the DBP has been kept unchanged from the one produced by STATEC in May and, therefore, it does not factor in recent economic developments, which point to a better outcome in 2016. Specifically, data for the second quarter of 2016, which were released after the DBP submission, point to a more sustained

growth in the current year. Additionally, more positive indicators, notably in the financial markets, along with more sustained growth in the euro area than previously assumed, bring in support for a stronger growth in 2016 than the one envisaged in the budget. For 2017, by contrast, the external environment has worsened compared to the projections in May by STATEC. The strong acceleration of economic output projected in the DBP is based on the assumption of a favourable evolution of financial markets and stronger external assumptions, notably for the euro area, which have been revised downwards since the spring.

**Box 1: The macro economic forecast underpinning the budget in Luxembourg**

The macroeconomic forecasts underlying the DBP have been prepared by the Direction "Etudes, prévisions et recherche" of the national statistical office STATEC<sup>1</sup>, which also provided the methodology for the calculation of the output gap. STATEC is an autonomous entity placed under the authority of the Ministry of Economy.

Its mandate and organisation were revised by the law of 10 July 2011<sup>2</sup>, which explicitly highlights STATEC's scientific and administrative independence, its ability to access to appropriate information to carry out its mandate and its capacity to communicate freely. Its director is appointed by the Grand-Duke. Its statutes contain provisions supporting independence of the institution as a body producing macroeconomic forecasts.

Taking into account the most recent data releases, the Commission 2016 autumn forecast projects a slight acceleration, with real GDP growing at a rate of 3.6% in 2016, after 3.5% in 2015. This is somewhat better than the 3.1% projected in the DBP. In 2017, under the assumption of a less dynamic external environment, notably in the euro area and a less benign assumption about the evolution of the financial markets, economic output is projected to grow by 3.8%, below the 4.6% in the DBP. Overall, the DBP macroeconomic assumptions underlying the budgetary projections can be assessed as cautious in 2016 and rather favourable in 2017.

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<sup>1</sup> Institut national de la statistique et des études économiques du Grand-Duché du Luxembourg.

<sup>2</sup> Loi du 10 juillet 2011 portant organisation de l'Institut national de la statistique et des études économiques et modifiant la loi modifiée du 22 juin 1963 fixant le régime des traitements des fonctionnaires de l'État.

**Table 1. Comparison of macroeconomic developments and forecasts**

	2015	2016			2017		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	3.5	2.9	3.1	3.6	4.5	4.6	3.8
Private consumption (% change)	1.8	3.5	3.5	2.3	3.2	4.2	4.6
Gross fixed capital formation (% change)	1.0	13.9	12.9	5.3	3.9	5.5	3.6
Exports of goods and services (% change)	12.8	4.9	9.8	2.7	6.9	10.0	3.9
Imports of goods and services (% change)	14.0	6.2	11.9	2.4	6.8	10.7	3.9
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	1.1	3.4	4.0	2.2	2.2	3.0	2.5
- Change in inventories	0.5	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.9	-0.5	-0.9	1.3	2.3	1.5	1.3
Output gap <sup>1</sup>	-1.9	-1.5	-1.7	-1.4	-0.6	-0.5	-0.9
Employment (% change)	2.6	2.9	3.0	2.8	2.4	3.2	2.9
Unemployment rate (%)	6.4	6.0	6.1	6.2	6.2	5.9	6.1
Labour productivity (% change)	0.9	-0.1	-0.8	0.8	2.0	1.1	0.9
HICP inflation (%)	0.1	-0.2	-0.2	0.0	1.3	1.3	1.6
GDP deflator (% change)	0.4	1.6	1.1	1.9	2.2	2.1	2.9
Comp. of employees (per head, % change)	0.9	0.5	0.7	0.4	2.9	3.3	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.1			6.1			6.1
<b>Note:</b>							
<sup>1</sup> In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.							
<b>Source:</b>							
Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations							

### 3. RECENT AND PLANNED FISCAL DEVELOPMENTS

#### 3.1. Deficit developments

According to the October 2016 EDP notification, the general government surplus for 2015 was revised upwards to 1.6% of GDP, higher than initially estimated in the most recent Stability Programme (1.3% of GDP). The better-than-expected outcome is mostly explained by lower investment expenditure at local government level than initially planned and some windfall revenues, whose elasticity was higher than anticipated.

According to the DBP, the general government surplus is projected to decline to 1.2% of GDP in 2016, as expenditure growth is expected to accelerate (4.5% after 3.5% in 2015), wherever revenues are estimated to remain dynamic (3.9% after 3.7% in 2015). Notably intermediate consumption is expected to return to expand at a rapid pace after a moderate evolution (2.3% on average) between 2013 and 2015. The national authorities also confirmed their commitment to maintain a high level of public investment, which is expected to increase in

line with economic output. Yet, the expected outcome is above the surplus of 0.8% of GDP set in the Stability Programme, and it fully reflects the positive base effect of the higher than projected surplus recorded in 2015. The positive surprise in 2015 was indeed mostly due to non-recurrent factors (as for instance the reimbursement of the excessive contribution to the EU budget) and temporary factors (e.g. a temporary retrenchment in public expenditure for investment), which will not occur again in 2016.

Concerning 2017, the DBP projects a drop in the general government surplus to 0.3% of GDP, mostly as a result of the implementation of the tax reform and the additional drop in e-VAT revenues stemming from the change in the e-commerce legislation. Nevertheless, this represents a slight improvement, mostly explained by a base effect from a better than planned outcome for 2016, compared with the budgetary trajectory outlined in the 2016 Stability Programme, where a balanced budget was projected. In 2017, overall expenditure is projected to increase at a quicker pace than in the previous year. While the government continues its efforts to limit the increase in public expenditure, the higher growth rate is mostly explained by the effect of inflation that in 2017 is expected to increase to 1.6%, to which a large part of the public expenditure is linked.

At the level of government subsectors, the deficit of the central government is expected to rise to 1.7% of GDP in 2017 from 0.8% of GDP in 2016, due to the budgetary impact of the tax reform and the e-VAT related losses. By contrast a steady surplus is projected for the local government and the social security sectors.

The Commission 2016 autumn forecast foresees a general government surplus of 1.3% of GDP in 2016, which declines to a balanced budget in 2017. Differences compared to the DBP are mostly explained by a less dynamic underlying economic scenario (3.8% compared to 4.6% in DBP) and a slightly higher estimation of the impact of the tax reform (0.8% of GDP compared to 0.7% in the DBP).

**Table 2. Composition of the budgetary adjustment**

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
<b>Revenue</b>	<b>43.7</b>	<b>42.3</b>	<b>43.3</b>	<b>43.0</b>	<b>40.6</b>	<b>42.0</b>	<b>41.2</b>	<b>-1.7</b>
<i>of which:</i>								
- Taxes on production and imports	12.2	11.6	11.7	11.8	10.9	11.3	11.2	-0.9
- Current taxes on income, wealth, etc.	14.6	14.6	14.9	14.7	13.8	14.5	13.7	0.0
- Capital taxes	0.1	0.1	0.2	0.1	0.1	0.3	0.1	0.1
- Social contributions	12.2	11.8	12.1	11.9	11.7	11.9	11.7	-0.3
- Other (residual)	4.6	4.2	4.4	4.4	4.1	4.0	4.4	-0.5
<b>Expenditure</b>	<b>42.1</b>	<b>41.6</b>	<b>42.1</b>	<b>41.7</b>	<b>40.6</b>	<b>41.7</b>	<b>41.2</b>	<b>-0.4</b>
<i>of which:</i>								
- Primary expenditure	41.7	41.2	41.7	41.3	40.3	41.4	40.8	-0.4
<i>of which:</i>								
Compensation of employees	8.8	8.6	8.8	8.6	8.4	8.6	8.4	-0.2
Intermediate consumption	3.6	3.7	3.7	3.6	3.6	3.6	3.6	0.0
Social payments	20.1	19.5	19.9	19.7	19.2	19.5	19.6	-0.6
Subsidies	1.4	1.3	1.4	1.4	1.2	1.4	1.4	0.0
Gross fixed capital formation	4.0	4.2	4.0	4.3	3.9	4.0	4.2	0.0
Other (residual)	3.9	3.9	3.9	3.8	4.0	4.3	3.7	0.4
- Interest expenditure	0.4	0.4	0.4	0.4	0.3	0.4	0.4	0.0
<b>General government balance (GGB)</b>	<b>1.6</b>	<b>0.8</b>	<b>1.2</b>	<b>1.3</b>	<b>0.0</b>	<b>0.3</b>	<b>0.0</b>	<b>-1.3</b>
<b>Primary balance</b>	<b>2.0</b>	<b>1.1</b>	<b>1.6</b>	<b>1.7</b>	<b>0.3</b>	<b>0.7</b>	<b>0.4</b>	<b>-1.3</b>
One-off and other temporary measures	0.2	0.0	0.0	0.0	0.0	0.0	0.0	-0.2
<b>GGB excl. one-offs</b>	<b>1.4</b>	<b>0.8</b>	<b>1.2</b>	<b>1.3</b>	<b>0.0</b>	<b>0.3</b>	<b>0.0</b>	<b>-1.1</b>
Output gap <sup>1</sup>	-1.9	-1.5	-1.7	-1.4	-0.6	-0.5	-0.9	1.1
Cyclically-adjusted balance <sup>1</sup>	2.4	1.4	1.9	1.9	0.3	0.5	0.4	-1.8
<b>Structural balance (SB)<sup>2</sup></b>	<b>2.2</b>	<b>1.4</b>	<b>1.9</b>	<b>1.9</b>	<b>0.3</b>	<b>0.5</b>	<b>0.4</b>	<b>-1.6</b>
Structural primary balance <sup>2</sup>	2.6	1.8	2.3	2.3	0.6	0.9	0.8	-1.6

Notes:

<sup>1</sup>Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

<sup>2</sup>Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:  
Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

In structural terms, the DBP projects the (recalculated) structural balance<sup>3</sup> at 1.9% of GDP in 2016. The surplus is projected then to decline to 0.5% of GDP in 2017. By comparison, in the Stability Programme, the (recalculated) structural balance was estimated at 1.4% of GDP for 2016 and 0.3% of GDP for 2017. These developments are in line with those in the

<sup>3</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

Commission 2016 autumn forecast, where the structural surplus balance is projected to decrease from 2.2% of GDP in 2015 to 1.9% of GDP in 2016. In 2017, the structural balance is expected to decrease to 0.4% of GDP, marginally lower than in the DBP.

Interest expenditure is set to remain stable at around 0.4% of GDP over the period 2016-2017. In line with the low level of government debt, Luxembourg interest expenditure has remained modest at 0.4% of GDP, compared to 2.4% of GDP on average for the euro area as a whole. In addition, over the past years Luxembourg has benefitted from stable and favourable financing conditions. The implicit interest rate in 2016 is estimated at 1.9% compared to 2.4% for the euro area as a whole.

Risks to the above fiscal outlook refer to the possibility that the cost of the envisaged tax reform could reveal higher than expected. In the medium-long term risks are related to the macroeconomic outlook and, in particular, to the financial sector remaining the main engine of the domestic economy. Regulatory and external risks remain and could adversely impact the sector and overall growth perspectives including the budgetary outlook. Moreover, additional risks are mostly related to the impact of the ongoing international initiatives to fight tax avoidance strategies used by multinational companies. Nevertheless, these risk factors are dependent on international developments, on which the national authorities have a limited control. Finally, the recurrent and sizeable revisions to which national accounts are subjected constitute an obstacle as they oblige the national authorities to define a budgetary trajectory on the basis of changing-in-the-past underlying macroeconomic scenario.

### **3.2. Debt developments**

In the DBP, the national authorities reiterate their commitment to maintain the public debt-to-GDP ratio under the national threshold of 30% and therefore, well below the Treaty threshold of 60%. The debt-to-GDP ratio is projected to increase from 22.1% in 2015 to 23.6% in 2017, although the primary surplus remains positive throughout the period covered by the DBP. This is explained by the evolution of the central government, whose balance is expected to move from a deficit of 0.3% of GDP in 2015 to a deficit of 1.7% of GDP in 2017, mostly due to the impact of the tax reform. According to the law, the surpluses of the social security sector are allocated to a reserve fund (the so-called "*Fonds de compensation commun au régime général de pension*") with the aim to cover future pension expenditure and they cannot be used to finance the needs of the central government<sup>4</sup>. These results are in line with the Commission forecast.

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<sup>4</sup> The breakdown of the general government balance shows that, while the social security sector traditionally posts a surplus of more than 1% of GDP, the central government records a deficit, and the balance of the local government sector is broadly neutral. As a consequence, the central government needs to issue debt even in case of a balanced budget.

**Table 3. Debt developments**

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
<b>Gross debt ratio<sup>1</sup></b>	<b>22.1</b>	<b>22.4</b>	<b>23.2</b>	<b>23.2</b>	<b>22.9</b>	<b>23.6</b>	<b>23.3</b>
Change in the ratio	-0.7	0.3	1.1	1.1	0.5	0.4	0.1
<i>Contributions<sup>2</sup> :</i>							
<b>1. Primary balance</b>	<b>-2.0</b>	<b>-1.1</b>	<b>-1.6</b>	<b>-1.7</b>	<b>-0.3</b>	<b>-0.7</b>	<b>-0.4</b>
<b>2. “Snow-ball” effect</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.5</b>	<b>-0.7</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-1.1</b>
<i>Of which:</i>							
Interest expenditure	0.4	0.4	0.4	0.4	0.3	0.4	0.4
Growth effect	-0.8	-0.6	-0.7	-0.7	-0.9	-1.0	-0.8
Inflation effect	-0.1	-0.3	-0.2	-0.4	-0.5	-0.5	-0.6
<b>3. Stock-flow adjustment</b>	<b>1.8</b>	<b>2.0</b>	<b>3.2</b>	<b>3.5</b>	<b>1.9</b>	<b>2.2</b>	<b>1.6</b>

**Notes:**

<sup>1</sup> End of period.

<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

*Source:*  
Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

### 3.3. Measures underpinning the draft budgetary plan

The fiscal strategy for 2017 is marked by the impact of the planned reform of the tax code, with regard to which the DBP provides detailed information. The tax reform is expected to enter into effect in 2017. It entails the introduction of a significant number of new tax measures concerning at the same time corporate and personal income taxation as well as indirect taxes. In particular, with respect to personal income taxation a not-exhaustive list of measures includes: (i) the repeal of the 0.5% temporary contribution levied on personal incomes introduced in 2015, (ii) a revision of the personal income tax brackets introducing more progressivity by increasing the number of tax brackets including the introduction of two new marginal tax rates of 41% and 42% for annual incomes above EUR 150 000 and EUR 200 000, (iii) an increase of tax credits for employees, pensioners, self-employed and single parents, (iv) the upward revision of the deductibility ceilings for interest on loans for house purchases and (v) an increase of the tax allowance granted for complementary pension schemes. Moreover, it introduces the option for individual taxation of couples. Concerning the corporate income taxation, the reform provides for a gradual decrease of the tax rate from 21% to 19% in 2017 and to 18% in 2018. In addition, the tax rate applicable to smaller companies will be reduced from 20% to 15%, while the scope of eligible companies has been enlarged to include companies with a taxable income not exceeding EUR 25.000 (up from EUR 15.000) Finally, the reform includes measures aimed at tackling the housing shortage and at greening the economy. The overall budgetary impact of the reform is deficit increasing and is estimated at around 0.7% of GDP in 2017.

Moreover, since the 2014 budget cycle, the annual budget is accompanied and complemented by a multi-annual financing law (MAFL) that covers a rolling period of 5 years and articulates the medium-term budgetary strategy. This year, the MAFL integrates the information on the tax reform with update estimations about the incremental impact of measures adopted with the 2015 budget, notably on the revenue side, the 2 percentage points increase in all VAT rates from 1 January 2015 and on the expenditure side the package of more than 250 saving measures, named "ZukunftsPak", to be implemented over the period 2015-2018.

Luxembourg's budgetary strategy also includes maintaining a high level of public investment. In 2015, gross fixed capital formation of general government stood at 4.0% of GDP compared to 2.7% on average in the euro area. According to the DBP, the national authorities plan to maintain the current level of investment or even increasing it.

**Table 4. Main discretionary measures reported in the DBP**

**A. Discretionary measures taken by General Government - revenue side**

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	2017	2018
Taxes on production and Current taxes on income, Capital taxes Social contributions Property Income Other	n.a.	-0.7	-0.9
<b>Total</b>	n.a.	-0.7	-0.9
<u>Note:</u> The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure. <i>Source: Draft Budgetary Plan for 2017</i>			

**4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT**

According to the information provided in the DBP, Luxembourg is expected to achieve a (recalculated) structural surplus of 1.9% of GDP in 2016, after a surplus of 2.2% of GDP in 2015. This is well above its MTO of 0.5% of GDP. For 2017, in line with the downward revision of the minimum MTO, Luxembourg has chosen to revise its MTO from a surplus of 0.5% of GDP to a deficit of 0.5% of GDP. Based on the information in the DBP, with a surplus of 0.5% of GDP the (recalculated) structural balance is expected to remain above the MTO.

These conclusions are confirmed by the Commission 2016 autumn forecast.

### **Box 2: Council recommendations addressed to Luxembourg**

On 12 July 2016, the Council addressed recommendations to Luxembourg in the context of the European Semester. In particular, in the area of public finances the Council recommended to Luxembourg to ensure the long-term sustainability of public pensions by increasing the effective retirement age, by limiting early retirement and increasing incentives to work longer, and by aligning the statutory retirement age to changes in life expectancy.

### **Box 3: Implementation of the "constrained judgement" approach and its impact in the context of the fiscal surveillance**

The April 2016 Amsterdam Informal ECOFIN Council requested that improvements be made to the commonly agreed methodology for the estimation of potential growth and the output gap. In response to this mandate from the Council, two concrete decisions were taken in agreement with the Member States in October 2016. First, it was agreed that a revised methodology for the estimation of the non-accelerating wage rate of unemployment (NAWRU) would be introduced in the commonly agreed methodology. This change has already been implemented in the Commission 2016 autumn forecast. Second, in line with the renewed mandate provided by the ECOFIN Council on 11 October, the Economic Policy Committee – Output Gap Working Group has worked on a "constrained judgement" approach for cases where the common method is shown to produce counterintuitive output gap results for individual Member States.

The objective of the "constrained judgement" approach is to have a transparent and economically grounded tool to statistically test the plausibility of the output gaps for individual Member States estimated on the basis of the common method. To this end, the Commission developed in cooperation with the Member States an objective screening tool to assess if the common methodology produces plausible output gap estimates for all Member States. If this "plausibility" tool identifies counter-intuitive results, the Commission has carried out an "in depth" analysis.

For Luxembourg, the plausibility tool provided indications that the output gap estimated for 2016 at -1.4% on the basis of the common methodology may be counterintuitive as it compares with more negative values of -3.4% estimated on the basis of this tool. The estimation of the output gap in Luxembourg is surrounded by a larger-than-usual degree of uncertainty, due to the special features of the economy, namely the presence of large financial sector and a large share of non-resident workers in its labour force. These specific features of Luxembourg's economy are not taken into account by the plausibility tool and therefore its application to Luxembourg seems not appropriate. Furthermore, the national Fiscal Council has carried out in October 2016 an alternative estimation of the output gap on the basis of the HP filter methodology, in the context of its evaluation of compliance of the national fiscal targets with the budgetary rules. According to this estimation the output gap for 2016 would be, by contrast, less negative compared with the output gap from the common methodology.

In the light of the uncertainty surrounding the estimation of the level of the output gap for Luxembourg, the Commission does not see sufficient ground to deviate from the output gap estimated on the basis of the commonly agreed methodology.

**Table 5: Compliance with the requirements of the preventive arm**

(% of GDP)	2015	2016		2017	
<b>Initial position<sup>1</sup></b>					
Medium-term objective (MTO)	0.5	0.5		-0.5	
Structural balance <sup>2</sup> (COM)	2.2	1.9		0.4	
Structural balance based on freezing (COM)	2.2	1.9		-	
<b>Position vis-a-vis the MTO<sup>3</sup></b>	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	<b>2015</b>	<b>2016</b>		<b>2017</b>	
	<b>COM</b>	<b>DBP</b>	<b>COM</b>	<b>DBP</b>	<b>COM</b>
<b>Structural balance pillar</b>					
Required adjustment <sup>4</sup>	Compliant				
Required adjustment corrected <sup>5</sup>					
Change in structural balance <sup>6</sup>					
One-year deviation from the required adjustment <sup>7</sup>					
Two-year average deviation from the required adjustment <sup>7</sup>					
<b>Expenditure benchmark pillar</b>					
Applicable reference rate <sup>8</sup>	Compliant				
One-year deviation <sup>9</sup>					
Two-year average deviation <sup>9</sup>					
<b>Conclusion</b>					
Conclusion over one year	Compliant				
Conclusion over two years					
<u>Notes</u>					
<p><sup>1</sup> The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.</p> <p><sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.</p> <p><sup>3</sup> Based on the relevant structural balance at year t-1.</p> <p><sup>4</sup> Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).</p> <p><sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.</p> <p><sup>6</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.</p> <p><sup>7</sup> The difference of the change in the structural balance and the corrected required adjustment.</p> <p><sup>8</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.</p> <p><sup>9</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p>					
<u>Source</u> :					
Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.					

## 5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The DBP provides a list of the measures that have been already adopted or are planned to be adopted in order to ensure an adequate follow-up of the 2016 CSRs.

As regards the fiscal recommendation (see Box 2), which called to improve the long-term sustainability of the public finances, the DBP mentions measures such as the reform of the professional classification scheme for persons with partial incapacity and the planned reform of early-retirement schemes. Savings from the implementation of the two measures are expected to be limited, as in particular the reform of early-retirement schemes, while suppressing some of them, provides for easing of restriction on other kinds of early retirement schemes.

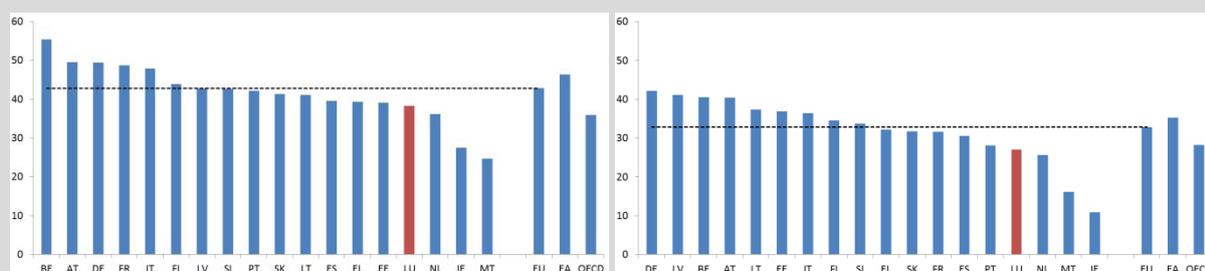
A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2017 Country Reports and in the context of the CSRs to be adopted by the Council in 2017.

### Box 4: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Luxembourg for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

#### The tax burden on labour in Luxembourg at the average wage and a low wage (2015)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Luxembourg's Draft Budgetary Plan contains measures that are expected to further lower the tax wedge on labour. In the context of the announced reform of the tax code, a reduction of the personal income tax is envisaged. The reform aims at making the system more progressive by adding tax

brackets including two new marginal tax rates for the highest incomes. Moreover, tax credits for employees and pensioners will be increased. The reform is expected to take effect as of 1st January 2017. While the reform as a whole contains few measures that aim at increasing fiscal revenues, it is deficit-increasing with its impact in the first year estimated at 0.7% of GDP. At full regime the impact of the reform is projected to increase at around 0.9% of GDP. The tax measures are expected to preserve the competitiveness of its economy and increase households' disposable income and have a positive effect on employment and on growth through higher private consumption.

## **6. OVERALL CONCLUSION**

According to the information provided in the DBP, the structural balance is planned to remain above the medium-term objective in 2016 and 2017. The Commission 2016 autumn forecast confirms that the structural balance will remain above the MTO in 2016 and 2017.